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Department of the Treasury
Washington, DC 20224

Third Party Communication: Private Firm
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:EEE:EOET:ET2
PLR-111059-20

Date:
October 21, 2020

Legend

State	=
City	=
Organization 1	=
Organization 2	=
University	=
College M	=
Statute	=
Section A	=
Section B	=
M Center	=
Community	=

Dear :

This responds to your letter dated April 27, 2020, requesting a ruling on behalf of Organization 1 and Organization 2 concerning their liabilities for taxes under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA). Specifically, you have requested a ruling on the status of Organization 1 and Organization 2 as wholly-owned instrumentalities of State for purposes of sections 3306(c)(7) and 3121(b)(7) of the Internal Revenue Code (the Code).

Organization 2 received a letter from the Service recognizing that it is an organization exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). Organization 1 was organized by the University exclusively for charitable, educational and scientific purposes within the meaning of section 501(c)(3)

of the Code and for the benefit of, to perform the functions of, and to carry out the purposes of University and its medical school, College M. University was created to be a state university per Section A and Section B of the Statute. Further, it is represented that University is a political subdivision of State.

Organization 2 was established to provide medical and health education to medical and health science students, to pursue research in the health care and health service field and to deliver medical and other health care services to the Community.

University is Organization 2's sole member. Organization 2's regulations specify that University shall exercise its authority over Organization 2 through the following individuals: (a) President of University; (b) Executive Vice President for Clinical Affairs and Dean of College M; and (c) Three individual members of University's Board of Trustees. In addition, such regulations provide Organization 2's actions are under the supervision of its Board of Directors (the Board), which is composed of the following individuals: (a) Dean of College M as the chairperson of the Board; (b) Chairperson of each clinical department of College M; (c) Nine faculty members of College M; (d) President of Organization 2 as an ex-officio voting member; and (e) Two additional ex-officio non-voting members: the Executive Director of Organization 2 and the Executive Director of the College M Hospitals. It is represented that all voting members of the Board are employed by and under the direction and control of College M or University.

While the Board has authority to oversee Organization 2, Organization 2 is accountable to University, through annual accountings submitted by the Board to University. Upon Organization 2's dissolution, its assets shall be distributed to University to the extent that it is a political subdivision per section 115 of the Code. Otherwise, the assets shall be conveyed to such organization as selected by the Board to the extent that such organization is exempt from federal income taxation under section 501(c)(3) of the Code or is a political subdivision per section 115 of the Code.

Organization 2 provides professional medical and related health care services through its wholly-owned single member limited liability company, Organization 1. Organization 1 is directly controlled by its manager, Organization 2, and indirectly controlled by University, as Organization 2 is under the control of University.

Organization 1's regulations specify that Organization 1 was organized for the benefit of, to perform the function of, and to carry out the purposes of College M and Organization 2. Organization 1 acts as the Faculty Practice Plan for College M whereby members of the faculty at College M engage in the practice of medicine to the extent they hold a clinical faculty appointment at College M. Further, Organization 1 provides care and treatment to patients of the M Center, an unincorporated division of University, and to the Community.

Organization 1 employs all of the health care providers and, accordingly, controls the compensation of such health care providers, including physicians, advanced practice

providers, nurses, and support personnel with respect to clinical services. Organization 1's regulations specify that its net earnings shall not inure to the benefit of any private individuals or any director, trustee, officer, or employee of Organization 1.

Upon Organization 1's dissolution, its assets shall be distributed to Organization 2, or to another organization exempt from federal taxation under section 501(c)(3) of the Code selected by Organization 2 in the event that Organization 2 is not qualified as exempt under section 501(c)(3) at such time.

College M is affiliated with University, a state university and political subdivision of State, chartered under the provisions of the laws of State. The statutes of State specifically establish University and confer upon its trustees the power to employ such officers, professors, teachers, and other employees as necessary. Further, Organization 1's Articles provide that only physicians and health professionals who have clinical faculty appointments in College M are eligible to practice medicine as employees of Organization 1.

Law

Sections 3101 and 3111 of the Code impose FICA taxes on the wages paid by employers to employees with respect to employment. Sections 3101(a) and 3111(a) impose Old-Age, Survivors, and Disability Insurance (OASDI) taxes on the wages of employees. Sections 3101(b) and 3111(b) impose Hospital Insurance (Medicare) taxes on the wages of employees.

Section 3121(b)(7) provides that, for purposes of the FICA tax, "employment" does not include service performed in the employ of a state, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing that is wholly-owned thereby. Section 3121(b)(7)(F) of the Code and section 31.3121(b)(7)-2(c)(1) of the Treasury Regulations provide that this exception does not apply to services performed after July 1, 1991, if the employee is not a "qualified participant" in a retirement system of the state, political subdivision, or instrumentality.

Section 3121(u)(2) of the Code provides that, for services performed after March 31, 1986, section 3121(b)(7) does not relieve state and local government employers and employees of liability for the Medicare portion of the FICA tax imposed by sections 3101(b) and 3111(b) of the Code. Generally, remuneration paid for services of an employee of a state, local government, or one of their instrumentalities is subject to Medicare taxes unless the continuing employment exception provided by section 3121(u)(2)(C) applies. Generally, the continuing employment exception from Medicare taxation in section 3121(u)(2)(C) may apply if the employee has been continuously employed by the same governmental entity and was performing services prior to April 1, 1986.

Section 3301 imposes on every employer for each calendar year the tax under the FUTA equal to a certain percentage of wages. Section 3306(b) provides that wages for FUTA purposes means all remuneration for employment with certain specific exceptions. Section 3306(c)(8) of the Code provides that, for purposes of the FUTA tax, “employment” does not include service performed in the employ of an organization described in section 501(c)(3) and exempt from income tax under section 501(a).

Section 3306(c)(7) of the Code provides that, for purposes of the FUTA tax, “employment” does not include service performed in the employ of a state, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned by one or more states or political subdivisions.

Under the check-the-box rules, an eligible entity that has a single owner (i.e., a “wholly owned entity”) and isn’t treated as a corporation, is disregarded as an entity separate from its owner. That means that its activities are treated the same as a sole proprietorship, branch, or division of the owner under Regulation section 301.7701-2(a).

The rule disregarding the entity status of a wholly-owned entity does not apply to the taxes imposed under Subtitle C (i.e., FICA, FUTA, and Federal income tax withholding, hereinafter referred to as “employment tax”). For employment tax purposes, section 301.7701-2(c)(2)(iv) of the Regulations provides that an entity that is otherwise disregarded as an entity separate from its owner is treated as a corporation, separate from its single owner.

Further, in the preamble to the final regulations under section 7701 that became effective in 2007 (see Treasury Decision 9356, 2007-39 I.R.B. 675, 72 F.R. 45891), the IRS stated:

Section 3306(c)(8) provides that services performed for an organization described in section 501(c)(3) are excepted from the definition of employment for Federal Unemployment Tax Act (FUTA) purposes. Even though a disregarded entity owned by a section 501(c)(3) organization will be regarded for employment tax purposes, the disregarded entity will continue to be considered an unincorporated branch or division of the section 501(c)(3) organization for other Federal tax purposes. For example, the disregarded entity will be considered an unincorporated branch or division of the section 501(c)(3) organization for purposes of the organization's annual information reporting requirements under section 6033. See Announcement 99-102 (1999-2 CB 545). Because section 3306(c)(8) looks to the employer's status for income tax purposes to establish the basis for exemption from FUTA, a disregarded entity owned solely by a section 501(c)(3) organization is considered exempt from tax under section 501(c)(3) for purposes of section 3306(c)(8). Thus, a disregarded entity owned solely by a section 501(c)(3) organization will not be subject to FUTA tax on wages it pays its employees.

The following six factors are considered in determining whether an organization is an instrumentality of one or more states or political subdivisions: (1) whether the organization is used for a governmental purpose and performs a governmental function; (2) whether performance of its function is on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner; (4) whether control and supervision of the organization are vested in public authority or authorities; (5) whether express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality, and whether such authority exists; and (6) the degree of financial autonomy and the source of its operating expenses. See Rev. Rul. 57-128, 1957-1 C.B. 311.

Analysis

We apply the factors in Rev. Rul. 57-128 to determine whether Organization 2 and Organization 1 are wholly-owned instrumentalities of State. Under section 301.7701-2(c)(2)(iv) of the Treasury Regulations, Organization 1 is treated as a corporation separate from its owner for employment tax purposes. Therefore, we apply the factors in Rev. Rul. 57-128 to each organization separately to determine whether Organization 2 and Organization 1 are wholly-owned instrumentalities of State.

Organization 2 performs a legitimate governmental purpose by supporting the educational mission of University and College M and providing medical and other health services to the Community. Organization 1 also performs a legitimate governmental purpose as it was intended to operate collaboratively with Organization 2 and was formed to function as a unitary component of Organization 2 by acting as the Faculty Practice Plan for College M to provide health care as an integral component of the academic and research mission of University, and to coordinate and provide for the clinical care aspect of such activities. Organization 1 is the operational entity in providing health care services and it employs all the health care providers and support personnel. As such, Organization 2 and Organization 1 satisfy the first factor of Rev. Rul. 57-128 since they are both used for a governmental purpose of educating students at College M and both perform governmental functions of teaching medical students through clinical instruction and research activities, as well as providing medical and other health care services.

Both Organization 2 and Organization 1 satisfy the second factor, performance of functions on behalf of the state. Organization 2 was formed to carry out the purposes of University and its medical school, College M. In turn, Organization 1 was formed to carry out the purposes of College M and Organization 2. Further, Organization 2, through the actions of Organization 1, performs an ancillary function for College M at College M-operated hospitals by providing professional medical and related health care services.

Organization 2 represents that no private interests have any voting interests, and that State has the interest and powers of an owner through University, a political subdivision of State. Organization 2's regulations specify that it is wholly-owned by University, which

exercises its authority over Organization 2 through certain officers and employees of University as specified in Organization 2's regulations. Further, Organization 2's Board is composed of the following individuals: (a) Dean of College M as the chairperson of the Board; (b) Chairperson of each clinical department of College M; (c) Nine faculty members of College M; (d) President of Organization 2 as an ex-officio voting member; and (e) Two additional ex-officio non-voting members: the Executive Director of Organization 2 and the Executive Director of the College M Hospitals. Accordingly, Organization 2 is directly controlled by University, to whom it must submit annual accountings through the Board. Organization 2's assets are required to be used for charitable purposes and for the benefit of, to perform the functions of, and to carry out the purposes of University and College M. Upon dissolution, Organization 2's regulations specify its assets shall be distributed to University to the extent it is considered a political subdivision under section 115 of the Code, and if not, another section 501(c)(3) organization or political subdivision per section 115 selected by the Board.

Similarly, Organization 1 represents that no private interests are involved. Organization 1's regulations specify that its net earnings shall not inure to the benefit of any private interests. Further, Organization 1 is directly controlled by its single member, Organization 2, which functions as its manager. Ultimately, Organization 1 is indirectly controlled by University, as Organization 2 is under the control of University. As such, Organization 2 and Organization 1 satisfy the third factor insofar as both represent that no private interests are involved and that the state has interests and powers of an owner through University, a state university and political subdivision of State, whether directly in the case of Organization 2 or indirectly in the case of Organization 1.

The fifth factor in Rev. Rul. 57-128 requires that express or implied statutory authority be necessary for the creation and use of Organization 2 and Organization 1. Both Organization 2 and Organization 1 were created to further the educational and related health care purposes of University, a political subdivision of State and its medical school, College M. Section A of the Statute grants University's Board the authority to do all things necessary for the creation, proper maintenance, and successful and continuous operation of the University. Therefore, the fifth factor is satisfied.

The sixth and final factor in Rev. Rul. 57-128, which considers the degree of financial autonomy and the source of its operating expenses, is also satisfied for Organization 2 and Organization 1. Organization 2's main source of income is generated by Organization 1 through the provision of medical services to patients by Organization 1 physicians who are also faculty members of College M. Organization 2 monitors Organization 1's finances through the use of an independent accounting firm. Further, University, a political subdivision of State, monitors Organization 2's finances through the use of the aforementioned annual accountings submitted by the Board. Solely on the basis of the information submitted, we rule as follows:

1. Organization 2 and Organization 1 have satisfied all of the factors listed in Rev. Rul. 57-128. Accordingly, we conclude that Organization 2 and Organization 1 are instrumentalities of State for purposes of Code section 3121(b)(7).

2. Therefore, for periods after July 1, 1991, wages paid to an employee of Taxpayer are subject to the OASDI portion of the FICA tax unless the employee is a qualified participant in a retirement system maintained by State. No opinion is expressed as to whether any employees of Organization 2 or Organization 1 are qualified participants in a retirement system maintained by State.

3. Wages paid to employees of Organization 2 and Organization 1 are generally subject to the Medicare portion of FICA tax, unless they qualify for the continuing employment exception under section 3121(u)(2)(C) of the Code. No opinion is expressed as to whether any employees of Organization 2 or Organization 1 qualify for this exception.

4. Organization 2 is an organization described in section 501(c)(3) of the Code as well as a wholly-owned instrumentality of State. Organization 1 is wholly-owned by Organization 2. Further, although Organization 1 is owned by Organization 2, it is indirectly controlled by University and satisfies all of the factors listed in Rev. Rul. 57-128. As such, we find that Organization 1 is also a wholly-owned instrumentality of State. Further, because section 3306(c)(8) looks to the employer's status for income tax purposes to establish the basis for exemption from FUTA, Organization 1 is considered exempt from tax under 501(c)(3) for purposes of the exemption under section 3306(c)(8) since it is wholly-owned by a section 501(c)(3) organization. Consequently, we conclude that the services of Organization 1 and Organization 2's employees do not constitute "employment" for purposes of FUTA taxes.

No opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. The above analysis is based on the assumption that Organization 2 and Organization 1 are not covered by a section 218 agreement. Furthermore, we do not express an opinion on whether the Organization 2 and Organization 1's retirement plan is a qualified plan or meets the requirements of section 31.3121(b)(7)-2 of the Regulations. Finally, we do not express an opinion as to whether the Organization 2 or Organization 1 and the University are an affiliated service group under section 414(m) or whether the Taxpayer's plan is a governmental plan under section 414(d).

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Lynne Camillo
Chief, Employment Tax Branch 2
(Employee Benefits, Exempt Organizations & Employment Tax)

cc: